

# **"I Never Knew It Could Be Like This": Lessons from the 1980s for California's Budget Crisis**

**Daniel J.B. Mitchell\***

Arnold Schwarzenegger is not the first governor to take office in a state budget crisis, preside over a budget improvement, and then find himself in another fiscal crisis. George Deukmejian, first elected in 1982, met a similar fate. Both Schwarzenegger and Deukmejian had to operate in the post-Proposition 13 era. By drastically cutting local property taxes, Prop 13 transferred major burdens of local government—especially schools—to the state. Both governors had to deal with a state budget that was balanced only in good times but not over the cycle. In addition to the problems faced by Deukmejian, Schwarzenegger has had to deal with the consequences of voter initiatives earmarking school finance and imposing term limits on the legislature. California's 2008 budget crisis is not a surprise. It is in many ways a repeat of the Deukmejian era.

In the film, *From Here to Eternity*, after a passionate embrace on a wave-swept beach, Deborah Kerr says to Bert Lancaster, "I never knew it could be like this." Some observers of the latest California budget fiasco—including Governor Arnold Schwarzenegger—have suggested that no one could have known that California would find itself in 2008 in a fiscal crisis of the same magnitude as the crisis that culminated in the 2003 recall of the governor's predecessor, Gray Davis. Indeed, when Governor

Municipal Finance Journal  
Winter 2009  
Vol. 29, # 4  
pp. 101 - 124

\*Daniel J.B. Mitchell is professor emeritus at UCLA's Anderson School of Management and School of Public Affairs. He is a past president of the International Banking, Economics and Finance Association and the author of *Pensions, Politics, and the Elderly: Historic Social Movements and Their Lessons for Our Aging Society* (M.E. Sharpe, 2000). He can be reached by email at danielj.b.mitchell@anderson.ucla.edu.

Schwarzenegger signed the previous year’s budget in August 2007, he proclaimed—incorrectly—that he had achieved a zero-deficit budget. But although he may feel that his fiscal predicament is unique, Arnold Schwarzenegger is not the first California governor to inherit a budget crisis, solve it sufficiently to be re-elected, and then end up where he started as his second term progressed. Another Republican, George Deukmejian, had a similar experience in the 1980s. Deukmejian, however, had two advantages relative to Schwarzenegger.

One was an accident of timing. The renewed crisis came late enough in Deukmejian’s second term that he was able to hand it off to his successor, Pete Wilson. The second advantage was that voters did not impose term limits until the end of the Deukmejian regime. Thus, Deukmejian had experienced legislative leaders with whom to work on fiscal matters. That fact helped him overcome the disadvantage faced by contemporary California governors: the requirement—dating back to the Great Depression—that budgets be enacted by a two-thirds vote of both houses of the legislature. Both Governors Deukmejian and Schwarzenegger took steps that, inadvertently perhaps, reduced the ability of the state to accumulate a reserve during good times. In the Deukmejian case, the misstep—which we will see was partly directed by voters—was to offer income tax rebates shortly before a renewed budget crisis developed. In the Schwarzenegger case, it was cutting the local governments’ “car tax” upon taking office, thus obligating the state to make the locals whole for the lost revenue. This paper traces the budgetary history of the Deukmejian administration and then further explores the parallels and differences between the Schwarzenegger period and the Deukmejian era.

## DEUKMEJIAN AND WILLIE BROWN

A “quintessential middle-class man,” George Deukmejian was elected to the California Assembly from the Long Beach area in the early 1960s and then to the State Senate.<sup>1</sup> He became leader in the senate, focusing on “law-and-order” issues. In 1978, Deukmejian became state attorney general. But Deukmejian seemed to harbor no ambition beyond the governorship. He did not run for president as did predecessor Jerry Brown or successor Pete Wilson.

In 1982, Deukmejian narrowly won over African-American Democrat Tom Bradley, the mayor of Los Angeles, in an election much rehashed during the 2008 Obama presidential campaign. Bradley led in the opinion polls but Deukmejian narrowly won, leading to the “Bradley Effect”

hypothesis, the dubious proposition that whites lie to pollsters about voting intent toward black candidates.<sup>2</sup> A rematch in 1986 between Bradley and Deukmejian, however, produced a landslide for the incumbent, a victory based on the latter’s seeming success in resolving the budget crisis left by Jerry Brown.

The most prominent personality in the legislature at that time was Speaker of the Assembly Willie Brown.<sup>3</sup> Brown, the first African American to hold the speakership, entered the assembly in the 1960s and initially clashed with Assembly Speaker “Big Daddy” Jesse Unruh. But Brown learned Unruh’s techniques of keeping control of his house. Those techniques were primarily extensive fundraising for assembly Democrats, maintaining goodwill with the opposition, and always having 41 votes—the minimum needed to elect a speaker of the 80-seat assembly.

Willie Brown was definitely dramatic—not so much in policy initiatives—but in quotable remarks, stylish suits, and public attention. In many respects, Proposition 140 of 1990—which imposed term limits—was an anti-Willie Brown initiative. Despite personality differences and differences in viewpoint and behavior, Willie Brown and George Deukmejian were sufficiently pragmatic to get along at strategic junctures. Indeed, there was often more friction between Brown and his Democratic counterpart in the senate, Senate President Pro Tem David Roberti, than with Republican Deukmejian.

The pragmatic relationship between Willie Brown and other key Democrats in the legislature and George Deukmejian did not mean that all went smoothly. Republicans pushed for redistricting throughout the 1980s, including attempts at redistricting by initiative.<sup>4</sup> The taxpayer revolt that

<sup>2</sup> Analysts have long expressed doubt that there was a Bradley Effect. See Jack Citrin, Donald Phillip Green, and David O. Sears, “White Reactions to Black Candidates: When Does Race Matter?” *Public Opinion Quarterly*, 54 (Spring 1990), pp. 74–96.

<sup>3</sup> See James Richardson, *Willie Brown: A Biography* (Berkeley: University of California Press, 1996); Richard A. Clucas, *The Speaker’s Electoral Connection: Willie Brown and the California Assembly* (Berkeley: Institute of Governmental Studies Press, 1995). Willie Lewis Brown, Jr., “First Among Equals: California Legislative Leadership, 1964–1992,” oral history conducted in 1991 and 1992 by Gabriele Morris, Regional Oral History Office, Bancroft Library, University of California, Berkeley, 1999; Willie L. Brown, Jr., and P.J. Cockey, *Basic Brown: My Life and Our Times* (New York: Simon & Schuster, 2008).

<sup>4</sup> Since the Pat Brown era, Republicans have rarely controlled the legislature. Thus, they have been likely to push for a “neutral” redistricting plan—as opposed to one drawn up by a Democratic legislature. One of Governor Schwarzenegger’s unsuccessful “Year of Reform” initiatives in 2005 sought to create redistricting by a panel of judges. For an earlier example, see Robert T. Monagan, *The Disappearance of Representative Government: A California Solution* (Grass Valley, CA: Comstock Bonanza, 1990). Monagan was briefly speaker of the assembly during a short period of Republican control (1969–1970). In November 2008, a Schwarzenegger-backed initiative—Prop 11—narrowly passed and will provide for redistricting by a neutral panel after the 2010 Census.

<sup>1</sup> Dan Walters, “Unspectacular Governance,” *Sacramento Bee*, February 19, 1986.

started with California's Prop 13 in 1978 continued to echo throughout the Deukmejian era. And there was a persistent focus on the death penalty. All of these issues led back to the California Supreme Court and its Chief Justice Rose Bird. Bird was appointed by Governor Jerry Brown in 1977. On the court, she managed to hit all these hot button issues by coming out on the liberal side.

Another clash of personalities involved Deukmejian and Bill Honig, Superintendent of Public Instruction. Prop 13 drastically cut local property taxes, and in the post-Prop 13 period, the state assumed a major role in financing local education. Honig, a former local school superintendent, was elected in 1982 to the "nonpartisan" position of state superintendent. In his elected capacity, Honig became a strong advocate of increased school finance, often accusing Deukmejian of shortchanging education. The school financing issue eventually moved to the ballot in 1988 with the passage of Proposition 98, an initiative sponsored by the California Teachers Association and strongly supported by Honig. Under Prop 98, roughly 40% of the state's general fund was earmarked for K-14 education by complex formulas.

## THE DEUKMEJIAN-ERA ECONOMY

Table 1 compares projections—made in December of the year before the forecast period—of the percent change in nonfarm payroll employment

growth (year-over-year) with the actual results. These forecasts were made by the UCLA Business Forecast and can be taken as similar to those that other state forecasters were making, including the California Department of Finance (which has to put together the governor's budget proposal at about the same time). The numbers suggest that the final years under Governor Jerry Brown would be a period of budget crisis (revenues falling short of planned spending).

The early Deukmejian years could be expected to be a period in which there would be surprisingly large revenue growth—allowing for increased spending and a buildup of budgetary reserves. We might further predict a mini-crisis from the table—but one that could be absorbed—around 1986, followed by pleasant budgeting until the final year or so of the Deukmejian era when a new crisis would unfold. What Table 1 suggests might have happened is what occurred.

## THE TRANSITION

As Figure 1 shows, California ran a surplus (revenue > expenditures) in the years immediately before Prop 13 was enacted in 1978.<sup>5</sup> Thereafter, the post-13 bailout of local governments turned the surplus into a deficit. Budget problems were aggravated by the economic downturn of the early 1980s, which cut into tax revenue. By the time Deukmejian took office, it was unclear whether the state would be able to pay its bills.

After the November 1982 election, a Deukmejian spokesperson—incoming Director of Finance Michael Franchetti—accused Jerry Brown of deliberately adopting a budget in the current fiscal year (1982–1983) that would "fall apart" just when he left office.<sup>6</sup> Because Brown did not know who would follow him—fellow Democrat Tom Bradley or Deukmejian—it is doubtful that he intended to leave a budgetary time bomb. But Jerry Brown probably did see an advantage in postponing budget problems until after the election in which he was running—unsuccessfully—against Pete Wilson for the U.S. Senate.<sup>7</sup>

Whatever the motive, the budget was falling apart. Governor Brown's director of finance admitted it had been based on forecasts of revenue that were "overly optimistic."<sup>8</sup> After the election, Deukmejian suggested

Table 1. UCLA California Employment Growth Forecast vs. Actual Results, 1981–1991		
Year	Forecast Made in Prior December	Actual Result
1981	3.0%	1.1%
1982	-0.5%	-1.8%
1983	0.2%	1.1%
1984	4.3%	4.8%
1985	3.5%	3.7%
1986	3.1%	2.6%
1987	3.2%	2.9%
1988	1.0%	3.8%
1989	2.2%	2.7%
1990	1.9%	2.1%
1991	-0.6%	-1.1%

Source: UCLA Business Forecasts for California; December before each year shown. Statistical Abstract of California. Note: Figures are year-over-year changes.

<sup>5</sup> California budgetary language often mixes stock and flow concepts and confuses the reserve with the annual balance of receipts and outlays. In this paper, surplus and deficit are used only as the annual difference between receipts and outlays.

<sup>6</sup> Douglas Shuit, "Deukmejian Will Face State Budget Deficit," *Los Angeles Times*, November 4, 1982.

<sup>7</sup> Wilson and Brown were running for the seat being vacated by Republican Sam Hayakawa.

<sup>8</sup> Douglas Shuit, "Deficit of \$1.1 Billion Projected for State; Rumors Confirmed," *Los Angeles Times*, November 11, 1982.

further deterioration of California's credit ratings. But in the end, no budget fix emerged from the legislature before Brown left office; the problem was inherited in total by George Deukmejian.

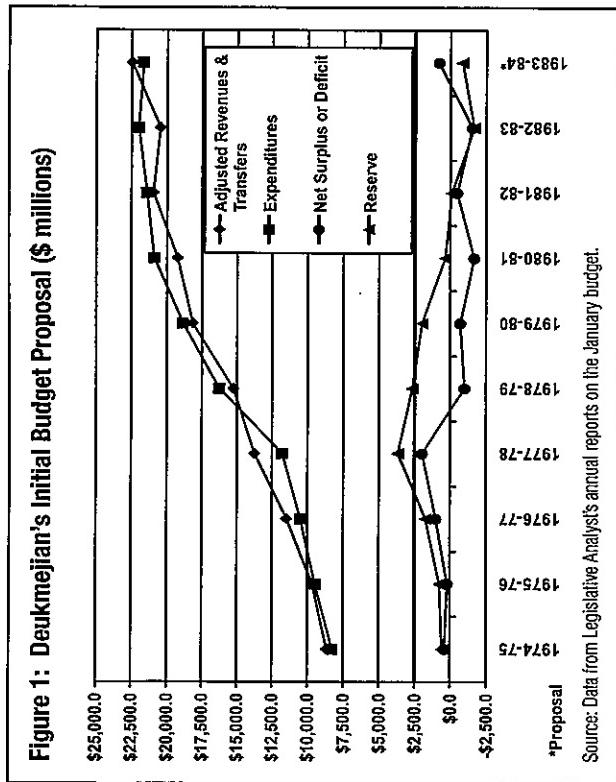
### YEAR ONE

In his inaugural address, Deukmejian indicated the fiscal crisis could be solved without a "net" tax increase—without defining what "net" meant.<sup>12</sup> He froze state hiring and cut other expenditures that were within the authority of the governor. Reductions in educational spending triggered increases in University of California and California State University tuitions.<sup>13</sup> Ultimately, any major budgetary actions required legislative assent. Discussions on taxes involved the possibility of temporary hikes that would disappear automatically when the fiscal situation improved. But the governor's official budget proposal for FY 1983–1984 contained no tax increase, only spending cuts.

Table 2 shows data from the Legislative Analyst's Office (LAO) for each fiscal year of the Deukmejian administration issued shortly after the governor's initial proposal. The LAO's estimate of the current general fund budget are in column 1 (1982–1983, when Deukmejian took office), and the proposal for the coming year (1983–1984) are in column 2. An improved "final" estimate the following summer for the prior year's budget (1982–1983) is presented in column 3.

The surplus or deficit in a year is the difference between "revenues and transfers" and "expenditures." The reserve can be viewed as a stock of money "in the bank" for the general fund at the end of a fiscal year. In concept, the reserve at the end of any fiscal year should be the reserve at the end of the prior year plus the surplus or deficit. In fact, later corrections on the revenue and expenditure sides—of unclear origin—lead to still later corrected reserve estimates, shown in column 4. Differencing the final estimate of the reserve (column 5) is an alternative estimate of what the surplus or deficit in a fiscal year actually was.

When Governor Deukmejian took office, estimates suggested that the deficit for the current fiscal year (1982–1983) was \$1.5 billion and that the reserve at the end of the fiscal year would be -\$1.6 billion. Later estimates showed somewhat more revenue and a good deal less expenditure, in part because of expenditure cuts. Still, by the end of that fiscal year—which was half over when the new governor took office—the reserve was in negative territory; even the final adjusted figure shows a reserve of about -\$450



Sources: Data from Legislative Analyst's annual reports on the January budget.

outgoing Governor Brown call a special session of the legislature to deal with the budget crisis. At that point, the state was already arranging emergency loans from Bank of America.

Even the Republican assembly leader Robert Naylor indicated that the crisis was so threatening that a tax hike might be needed. But Governor-Elect Deukmejian indicated that he would veto tax increases once he became governor (a threat that would not preclude enactment of such increases in the remaining days of the Brown administration).<sup>9</sup> Within a day of his no-tax declaration, Deukmejian changed tack and said that he was "not one who uses the word never, ever, or always."<sup>10</sup> However, he essentially returned to "never" as the budget battle unfolded.

Outgoing Governor Brown did call a special session.<sup>11</sup> And State Treasurer Jesse Unruh froze issuance of general obligation bonds to avoid

<sup>9</sup> Douglas Shuit, "Break Seen in Deadlock on State Budget," *Los Angeles Times*, November 19, 1982.

<sup>10</sup> Douglas Shuit, "Deukmejian Eases Off Opposition to Tax Hike," *Los Angeles Times*, November 20, 1982.

<sup>11</sup> Among the new assembly members were Gray Davis, Jerry Brown's former chief of staff, and Tom Hayden, then married to actress Jane Fonda.

<sup>12</sup> William Endicott and Claudia Luther, "Buzz Word" in Inaugural Speech Proves Buzzing," *Los Angeles Times*, January 4, 1983.

<sup>13</sup> The word "quittion" will be used in this article as opposed to the "fee" euphemism.

**Table 2: California State Budget History, General Fund (\$ millions)**

<b>(continued)</b>					
	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Revenue & transfers	1982-83 (E)	1983-84 (P)	1982-83	1982-83	1982-83
Expenditures	20,489.7	22,479.4	20,943.3		
Surplus/deficit	-22,005.0	21,674.6	21,461.5		
Reserve	-1,633.8	804.8	-518.2	-419.6	-416.5
Revenue & transfers	1983-84 (E)	1984-85 (P)	1983-84	1983-84	1983-84
Expenditures	22,641.2	25,076.4	22,575.2		
Surplus/deficit	126.4	749.1	940.3	1,021.4	
Reserve	205.2	954.3	490.7	571.8	
Revenue & transfers	1984-85 (E)	1985-86 (P)	1984-85	1984-85	1984-85
Expenditures	26,076.9	27,922.1	26,280.8		
Surplus/deficit	25,582.2	27,864.0	25,466.4		
Reserve	985.3	1,043.4	1,455.3	883.5	
Revenue & transfers	1985-86 (E)	1986-87 (P)	1985-86	1985-86	1985-86
Expenditures	28,709.0	30,698.9	28,570.9		
Surplus/deficit	-522.4	324.7	-709.1	-741.2	
Reserve	843.3	1,168.0	686.2	714.1	
Revenue & transfers	1986-87 (E)	1987-88 (P)	1986-87	1986-87	1986-87
Expenditures	30,764.8	31,742.0	32,277.1		
Surplus/deficit	-30,889.8	31,263.6	31,227.2		
Reserve	-1,561.3	1,039.7	625.9	681.5	-52.6
Revenue & transfers	1987-88 (E)	1988-89 (P)	1987-88	1987-88	1987-88
Expenditures	33,343.0	36,101.0	32,751.8		
Surplus/deficit	-335.0	148.0	-186.9	-36.9	
Reserve	962	1,110.0	174.6	224.6	

Source: Department of Finance, Legislative Analyst's Office.

Notes: Column 1 = Estimate for current fiscal year made in January of that year, i.e., half way through the year.

Col. 2 = Governor's January proposal for coming fiscal year. Column 3 = "Final" figures for fiscal year.

Department of Finance but excluding adjustments for differences later determined for revenues and expenditures.

Column 4 = Final figures for reserves including adjustments for differences later determined for revenues and expenditures. Column 5 = Surplus or deficit calculated from differences in reserves in column 4.

million, not a great result for what was then a \$21 billion annual budget.

However, the path even to that result was difficult. Although the governor's budget for the 1983-1984 year forecast a surplus, it would (based on the numbers available at that time) have left a significant negative reserve at the end of that year.

A week after submitting his no-tax-increase/negative-reserve budget for 1983-1984—resulting in an outcry from the legislature—the governor returned with a revision. It appeared that the state would soon run out of cash and would need to issue more registered warrants—even to individuals expecting tax refunds in spring 1983. The new plan entailed significant cuts in Prop 13 bailout funds for cities and counties during the 1983-1984 fiscal year, tuition increases for higher education, and other unpleasant actions. State bond ratings fell.

(continued)

By late January 1983, Tom Bradley was talking about a rematch against Deukmejian in 1986.<sup>14</sup> There was discussion about a tax increase that would be triggered and reversed automatically by a formula linked to economic conditions. But Deukmejian became more committed to a budget with no tax increase, even though it involved negative reserves and deficit finance. Other ideas were floated such as creating a state lottery, which the governor initially opposed but later said he was “willing to review.”<sup>15</sup>

The threat of the state having to pay its bills in registered warrants ultimately produced the pressure needed for a short-term solution. Treasurer Unruh and Controller Kenneth Cory called a press conference and sang “Turn out the lights; the party’s over.”<sup>16</sup> A loan was soon arranged by Treasurer Unruh and a 1-cent sales tax increase—to be triggered in October 1983 or January 1984 by deficiencies in revenues—was passed in mid-February. This device permitted the governor to avoid enacting a tax increase and at the same time provided some assurance to lenders. Still, Deukmejian became the only governor from Pat Brown through Arnold Schwarzenegger with a public approval rating below 50% within a short time after taking office.<sup>17</sup>

California governors traditionally issue a revised budget proposal in May for the coming fiscal year. Complicating the process in May 1983 was the sales tax trigger that was linked to whether the coming fiscal year (1983–1984) would end with a negative reserve. The governor predicted a positive reserve while Legislative Analyst William Hamm projected a deficiency. It turned out that the governor was correct, as can be seen in Table 2. Indeed, the reserve turned out to be much larger than the governor had projected. But this outcome reflected the improved condition of the state economy a year hence; its condition did not seem bright at forecast time.

The governor proposed no explicit tax increases but suggested closing various “loopholes” in the tax system—which effectively would generate more revenue. These proposals caused complaints by legislative Republicans that they were de facto tax increases. And as is often the case—particularly when the legislature and governorship are in the hands of different parties—the budget became entangled with other concerns. Among them was the

operation of the state’s Agricultural Labor Relations Board, created in the 1970s to aid the United Farm Workers union under César Chávez.

Officially, the legislature is supposed to pass a budget by June 15. A more significant date is June 30, so that the state can start the new fiscal year with a budget in place. In contemporary California, starting the fiscal year with no budget enacted has become routine. Various court decisions now keep much of the state’s spending going without a budget. But in 1983, failure to meet the June 30 deadline was more ominous. Yet there was no budget on July 1, 1983. The legislature’s majority essentially was insisting on enacting a definite 1-cent sales tax hike—not just a triggered one—which the governor opposed.

Because of the stalemate, various state checks were not written, including unemployment, disability, and welfare benefits.<sup>18</sup> Aggravating tensions in the legislature between Democrats and Republicans was a ballot proposition—the “Sebastani initiative”—to undo the redistricting plan passed in the waning days of the Brown administration.<sup>19</sup> The initiative qualified for the next ballot and Deukmejian could—and did—call a special election to pass the initiative that could cause redistricting before the regular 1984 elections.

Democrats withheld agreement on the budget partly on that issue. But, eventually, the governor called the election, effectively removing redistricting from the budget negotiations. The eventual budget worked out with the majority and minority leaders in the legislature by the governor—a grouping later known as the Big Five—was three weeks late. Upon receiving the budget, the governor vetoed \$1.1 billion, enough to avoid triggering the sales tax hike. Deukmejian’s vetoes enhanced his reputation as the “Iron Duke,” protector of California’s fiscal integrity.<sup>20</sup>

Not all the cuts-via-veto were strictly for fiscal reasons. Substantial cuts were made, for example, in the budget of the Agricultural Labor Relations Board, an agency disliked by Republicans, especially from farming areas. Although there was no general tax increase, a variety of loophole closings and other technical adjustments in the final budget raised the tax yield, despite complaints from the Republican minority. Nonetheless, the crisis of the first year was over once the new 1983–1984 budget was in place. And Governor Deukmejian was widely seen as having bested the Democratic majority in the legislature.

<sup>14</sup> Nancy Skelton, “Has Bradley’s Chance Passed? 2nd Governor’s Race Debated,” *Los Angeles Times*, January 24, 1983.  
<sup>15</sup> William Endicott, “Deukmejian Bases Opposition to Plan for State Lottery,” *Los Angeles Times*, April 6, 1983.  
<sup>16</sup> Douglas Shuit, “Unruh Riding High Again in State’s Circle of Power,” *Los Angeles Times*, March 20, 1983.  
<sup>17</sup> See *Field Poll*, January 15, 2004, p. 3, available at [www.field.com](http://www.field.com). The percent approving ratings were Schwarzenegger, 52%; Gray Davis, 58%; Pete Wilson, 52%; Deukmejian, 42%; Jerry Brown, 67%; Ronald Reagan, 58%; and Pat Brown, 51%.

<sup>18</sup> Eventually, court actions led to issuance of the checks.

<sup>19</sup> The initiative was named after Don Sebastani, a Republican assemblyman (and member of the winemaking family), who pushed it.

<sup>20</sup> Generally, Deukmejian was far more prone to veto bills than his predecessor or successor as governor. See Daniel Weintraub, *California Insider* (*Sacramento Bee*), weblog, October 14, 2003.

## THE BUDGET OUTLOOK IMPROVES

Deukmejian was seen by some commentators as more successful than Governor Ronald Reagan in holding back spending.<sup>21</sup> But one poll suggested that many Californians regarded the governor as "stubborn."<sup>22</sup> A variety of his clashes with the legislature were left over from the budget battle including funds for local governments and whether community colleges would charge added tuition to students. His special election on redistricting was killed by the state supreme court, leading the governor to propose a new redistricting plan, first to the legislature and then—if refused—to the electorate as another initiative.

These issues could have led to more bruising confrontations but for one development: the California economic recovery. Tax revenue increasingly flowed into Sacramento. Combined with the budget squeeze built into the 1983–1984 budget (including the vetoes), by October 1983, the new revenues led to a very different fiscal climate. Deukmejian's budget director was now forecasting large surpluses.<sup>23</sup> The conflicts switched to how to spend the windfall. Deukmejian wanted to build up the reserve first and then—if sufficient revenue were available—to offer tax rebates. Democrats pushed to restore past spending cuts.

The first round of the new conflict was refusal of the legislature to confirm Budget Director Michael Franchetti. Because Franchetti had been serving for a year without confirmation, he was forced to step down in January 1984. By that time, however, the proposed budget for 1984–1985 was already prepared.

As Table 2 shows, the estimate for the existing 1983–1984 budget surplus had climbed to over \$700 million and would later be revised to over \$1 billion. The proposal for 1984–1985 contained such pleasantries as a cut in the tuitions charged at state universities. With such happy news, the relations between the legislature and governor became friendlier. A Democratic assemblyman said of Deukmejian: "He's getting the honeymoon this year that he didn't get last year."<sup>24</sup> Even so, there were differences in priority between the governor and the legislature. The governor generally pushed for welfare cost-containment strategies. Nonetheless, in fiscal 1983–1984 and fiscal 1984–1985, the state ran a surplus, the general fund reserve grew, and the emergency bank loan to the state was repaid.

This background produced ongoing debates concerning tax cuts or rebates versus increased spending. Pushing for the increased spending option was Superintendent of Public Instruction Bill Honig, arguing for K-12 resources. The governor was more focused on enhancing *higher* education, a position reinforced by an informal partnership with University of California president David Gardner. State labor unions agitated for catch-up pay increases, including "comparable worth" increases for female-dominated jobs. Despite frictions with the governor, the legislature passed the 1984–1985 budget by the June 15 deadline. Deukmejian vetoed more than \$700 million—including money for the comparable worth pay raise. Later that year, a state lottery initiative passed—pushed by a firm that produced lottery equipment—and provided funds earmarked for education (Prop 37).

The budget for 1985–1986—a fiscal year that would end a few months before the November 1986 gubernatorial election—was developed in the context of rising revenues. Indeed, the legislative analyst criticized the governor's initial spending proposal as excessive. There were differences in priorities between the governor and the legislature. The governor continued to emphasize resources for the state's two university systems. Assembly Speaker Willie Brown pushed for more funding for community colleges. Governor Deukmejian stressed issues of efficiency in government: contracting out for services and holding down state civil service employment. However, squeezing public employment and contracting out were not concepts favored by legislative Democrats.

In the end, about \$500 million in spending was vetoed by the governor. The legislative analyst found the cuts to be more than needed to maintain the governor's target of a \$1 billion reserve.<sup>25</sup> However, as Table 2 shows, the reserve at the end of the fiscal year turned out to be about \$700 million, thanks to an unanticipated budget deficit as the economy slowed. Both the governor and the legislative analyst had been too optimistic.

By December 1985, the analyst was pointing to revenues below budget projections.<sup>26</sup> California was still benefiting from a defense buildup—the end of the Cold War was not in sight—but the national economy was being slowed by the Federal Reserve, which feared inflation. California couldn't escape the impact of the national slowdown.

## THE 1986 GUBERNATORIAL ELECTION YEAR

By fall 1985, the groundwork for the 1986 gubernatorial campaign was being laid. The issues would be the death penalty, law-and-order, and

<sup>21</sup> William Endicott, "Deukmejian's Big Advantage was Surprise," *Los Angeles Times*, August 7, 1983.

<sup>22</sup> William Endicott, "Deukmejian's Legislative Style Viewed as 'Stubborn,'" *Los Angeles Times*, August 18, 1983.

<sup>23</sup> Douglas Shuit, "State Budget Surplus May Spark New Fiscal Conflict," *Los Angeles Times*, October 18, 1983.  
<sup>24</sup> Jim Costa (Fresno) quoted in John Balzar, "Abundance Makes the Job Easier," *Los Angeles Times*, January 11, 1984.  
<sup>25</sup> "Duke Vetoed More Than Necessary," *Sacramento Bee*, July 19, 1985.  
<sup>26</sup> "Revenue Short of Goals," *Sacramento Bee*, December 20, 1985.

California Supreme Court Chief Justice Rose Bird. But budget issues that were so salient in 1982 were gone. Deukmejian took credit for fixing the budget crisis left by Jerry Brown, saying the state had gone from “TOU to A-OK” (despite reemergence of a deficit). The gubernatorial election would be a rematch with Tom Bradley.

## THE GANN CONSTRAINTS

Paul Gann was the neglected partner with Howard Jarvis in the 1978 Proposition 13 campaign. Prop 13 cut property taxes and created a two-thirds legislative requirement for enacting tax increases. Although Gann was eclipsed by the flamboyant Jarvis, he moved into the spotlight in 1979 with Proposition 4—termed the “Spirit of 13.” Prop 4 limited state expenditures to a formula based on population, personal income, and inflation.<sup>27</sup> If revenue exceeded the limit, the excess was to be returned to taxpayers. The taxpayer revolt was in full swing at the time so that the then-speaker of the assembly, Democrat Leo McCarthy, was one of the official endorsers of Prop 4. Unlike a prior initiative unsuccessfully pushed by Governor Reagan and later budget-limit-by-formula initiatives of Pete Wilson and Arnold Schwarzenegger, Prop 4 passed with 74% of the vote.<sup>28</sup> However, the economic slump of the early 1980s pulled revenue and expenditures well under the Gann limit. Years passed before the limit became a constraint.

When Deukmejian announced his budget proposal for 1986–1987 in January 1986, he pushed it up close to the Gann limit (by his finance director’s calculation). Being close to Gann meant it would be difficult for the legislature to add to the proposed spending. Indeed, Legislative Analyst William Hamm estimated that the Gann ceiling would be exceeded in the budget.<sup>29</sup> One of the ironies of the Gann issue was that business interests, which had supported the Gann initiative in 1979, began to back away from it and push for constitutional changes. Prop 4 lumped spending from the general fund with spending from special funds, notably transportation. Thus,

<sup>27</sup> An explanation of the original Prop 4 can be found in Lisa Martin, “Exploring the Gann Limit,” *Cal-Tax Digest*, June 2000, available at [www.caftar.org/documents/2000/jul00-9.htm](http://www.caftar.org/documents/2000/jul00-9.htm). See also California Legislative Analyst’s Office, “The State Appropriations Limit,” available at [www.lao.ca.gov/2000/04/1300\\_gann.pdf](http://www.lao.ca.gov/2000/04/1300_gann.pdf). According to former Legislative Analyst William G. Hamm, the actual text of the initiative was prepared by Gann by Vigo G. Nielsen, at the Republican-oriented law firm of Nielsen, Merksamer, Hodgson, Parinello & Mueller. See Oral History Interview with William G. Hamm, California Legislative Analyst, 1977–1986, California State Archives, State Government Oral History Program, Conducted 1989, p. 48.

<sup>28</sup> The earlier Reagan initiative is discussed in Daniel J.B. Mitchell, “Governor Reagan’s Ballot Box Budgeting: One That Got Away,” *Southern California Quarterly*, 89 (Summer 2007), pp. 195–227.

<sup>29</sup> Thorne Gray, “Duke’s Budget Tops Spending Limit, Analyst Says,” *Sacramento Bee*, January 28, 1986.

spending on roads and other infrastructure favored by business interests might suffer. But Deukmejian, through the Department of Finance, opined that proposals to change Gann were “premature.”<sup>30</sup> He later attacked rival Tom Bradley for advocating repeal of Gann.<sup>31</sup>

## BUDGET ISSUES VS. OTHER CONCERNs

The issue that began to eclipse all others was Rose Bird, Chief Justice of the California Supreme Court, and her rulings on death penalty cases. Prop 13, and other high-profile matters. “She has ruled against the people,” Deukmejian declared.<sup>32</sup> He criticized Bradley for failing to take a stand on Bird, who would be up for confirmation (or rejection) in the November 1986 election. The budget entered the campaign only indirectly, with Deukmejian labeling Bradley “tax-hike Tom” and boasting of the state’s triple-A bond rating.<sup>33</sup> And in the end, Bird was voted out along with two other justices, and the governor had gained a significant victory over Bradley with over 60% of the vote.

## UP AGAINST THE CEILING

Shortly after the election, the conservative Pacific Legal Center indicated it might take the state to court for exceeding the Gann limit. Deukmejian’s official position was that California was below the limit but that it would be difficult to remain there in the following fiscal year.<sup>34</sup> The new legislative analyst, Elizabeth Hill, thought that the limit was likely already exceeded.<sup>35</sup> Bill Honig, reelected to a second term, was talking about an initiative that would relax Gann for the benefit of schools.<sup>36</sup>

There were also indications from the Department of Finance that the governor’s targeted \$1 billion reserve in the general fund was endangered by higher-than-anticipated expenditures and lower-than-anticipated revenues. Earlier forecasts for the economy were scaled back. Still, there were also pressures to expand funding for transportation, which was potentially limited by Gann.

<sup>30</sup> Dan Walters, “Duke on Gann: Leave It Alone,” *Sacramento Bee*, June 15, 1986.

<sup>31</sup> “Deukmejian and Gann,” *Sacramento Bee*, July 20, 1986.

<sup>32</sup> Laura McCoy, “Duke: Bird Repeatedly ‘Ruled Against the People,’” *Sacramento Bee*, June 6, 1986.

<sup>33</sup> Jeff Rabin, “Bradley Would Hike Taxes, Duke Warns,” *Sacramento Bee*, October 4, 1986.

<sup>34</sup> Thorne Gray, “State May Slam into Budget Ceiling,” *Sacramento Bee*, November 26, 1986.

<sup>35</sup> Thorne Gray, “Analyst Says State May Outspend Gann Limit,” *Sacramento Bee*, December 4, 1986.

<sup>36</sup> “Honig Seeks More Funds to Push School Reforms,” *Sacramento Bee*, January 3, 1987.

In December 1986, the governor called for midyear cuts in the 1986-87 budget of 2% across the board (which would be 4% for the remaining six months of the fiscal year). Cuts in Medi-Cal reimbursements to doctors and other health providers triggered an outcry and litigation. With Gann in place, the alternative of raising taxes was not feasible. Under Gann, when spending was beyond the limit, more revenue would not support the excess in spending; it would have to be rebated.

## THE 1987-1988 BUDGET PROPOSAL

Deukmejian's January budget proposal for 1987-1988 was predicated on keeping within the Gann limit and restoring the reserve to \$1 billion. In the short run, the constraint of the limit produced a predictable outcry from those sectors, especially K-12, which felt shortchanged. Within K-12, the governor called for funds to be reallocated toward class-size reduction. Cal-OSHA, the job safety program run by the state, would be abolished and its function left to federal OSHA. The proposal to terminate Cal-OSHA put the governor in collision with organized labor—which filed litigation to halt the plan. Ultimately, after being shut down, Cal-OSHA was revived by a later initiative.

In the longer run, the Gann limit and the impact on K-12 education set in motion a process that continues to be felt today: Proposition 98 of 1988, which mandated spending on K-14 by formula and largely gutted Gann. In between the passage of Prop 98 and the initial pinch of the Gann ceiling came a large tax rebate for Californians with gubernatorial support.

## THE GANN REBATE: PHASE I

The original January 1987 budget proposal was based on an assumption of a revenue deficiency relative to projections. But by May 1987, it had become apparent that revenues were running ahead of projections. Additionally, changes in federal tax law induced taxpayers to take capital gains, an action that enhanced state income tax receipts on a one-shot basis. Governor Deukmejian announced that pursuant to Gann, he would provide a \$700 million rebate to taxpayers. His proposal sparked a debate with legislative Democrats pushing for ways to put the money into education instead. With Republicans supporting the rebate, an impasse developed. Deukmejian proposed giving taxpayers a choice on their income tax forms of keeping the rebate or giving it back to the government "in the interest of breaking the budget deadlock."<sup>37</sup> The proposal did not break the deadlock—centered in the assembly—and the state was without a budget on July 1, 1987.

Meanwhile, the estimate of the surplus that might be rebated had grown to \$1.1 billion. On July 2, the assembly relented and the legislature passed a budget that—while not explicitly providing a rebate—did not spend the extra funds. Assembly Speaker Willie Brown had effectively conceded the concept of a rebate in a deal with the governor, but not the form it would take. Deukmejian exercised his veto power to remove another \$663 million in expenditures.

## THE GANN REBATE: PHASE II

In late summer, a California Field Poll suggested that a majority of voters favored giving the rebate money back to schools. If offered an option of taking it or leaving it to schools themselves, about half said they would take it.<sup>38</sup> However, the governor had already won the conceptual rebate battle and pushed the legislature to approve a rebate plan whereby taxpayers would receive a check in the mail. Republicans thought a check in the mail would discourage a possible initiative to relax Gann. An unsuccessful revolt by a group of conservative Democrats—known as the "Gang of Five," put pressure on Willie Brown to agree to the specifics of the governor's rebate plan.<sup>39</sup>

Under the plan, checks of \$32 to \$236 would be sent to anyone who had filed a 1986 income tax return. Soon after the plan was enacted, the stock market crashed, creating uncertainty over the likely impact on the California economy and the state's tax receipts. Although the impact of the crash proved less damaging than initially feared, the event was a reminder that the economic predictions about the future on which any budget is based contain an element of risk.

## THE 1988-1989 BUDGET

Planning for fiscal 1988-1989 began relatively calmly. There were the expected disagreements over priorities. But revenue for the current 1987-1988 year turned out to be less than was projected in January 1988 at the time of the budget message. And, in the end, the 1987-1988 year concluded with a deficit well over \$400 million instead of the planned surplus of well over \$400 million.

The once-benign budgetary outlook began to appear threatening. Deukmejian proposed some tax "adjustments" but eventually withdrew them when faced with the charge of de facto tax increases, resulting instead in

<sup>37</sup> "Let Taxpayers Decide Rebate, Duke Says," *Sacramento Bee*, June 21, 1987.

<sup>38</sup> "Majority Would Spend Surplus on Schools," *Sacramento Bee*, August 25, 1987.

<sup>39</sup> Richard A. Clucas, *The Speaker's Electoral Connection: Willie Brown and the California Assembly* (Berkeley, CA: Institute of Government Studies Press, 1995), p. 143.

complaints of flip-flopping. However, there was enough of a reserve, even with the Gann rebate, to absorb the cost.

The governor and the legislature agreed on infrastructure bonds, partly because debt repayments were exempt from Gann. However, when the governor's transportation bond appeared on the ballot in June 1988, it lost (narrowly), another blow to Deukmejian along with the flip-flop charge and the current deficit. Nonetheless, a new budget for 1988–1989 was in place on July 9, after about \$470 million in gubernatorial vetoes. And the final estimates put the budget surplus for that year at about \$1 billion, more than enough to outweigh the 1987–1988 deficit. Despite the turn of events, the governor had been injured by the sequence of Gann rebate and then budget deficit for the 1987–1988 fiscal year.

## PROPOSITION 98

The sequence of rebate and deficit opened an avenue for advocates of relaxing Gann. But they decided to focus on education—a popular issue—rather than the obscure Gann formula. Essentially, education was the appeal of Prop 98, which appeared on the ballot in November 1988. Prop 98, in its original form, used two alternative formulas to provide minimum funding for K-14 education relative to the overall budget. A third formula was added by Proposition 111 of 1990, discussed below, which completed the gutting of Gann. Rather than explicitly lift the Gann limit, Prop 98 earmarked a share of any Gann surplus for K-14 so that the full amount would not be rebated. The education-focused Prop 98 started out with a California Field Poll in July 1988 indicating 63% of voters would approve it. But there was considerable opposition, and not just by fiscal conservatives. Because the proposition would earmark a substantial chunk of the general fund for K-14, other claimants feared a decline in their shares if it passed. By October 1988, 50% of voters polled were leaning to “yes.”<sup>40</sup> In November, Prop 98 passed with 50.7% of the vote. A major budgetary change in the state constitution—the most important since Prop 13—barely passed. But it altered California fiscal policy profoundly by encumbering roughly 40% of the general fund. Prop 98 was enacted just as cautionary notes were being sounded about the future of the California economy as the Cold War was ending, with adverse consequences for military spending. The end of the Cold War threatened employment in aerospace and allied industries and military bases. With these clouds over the budget, Governor Deukmejian announced he would not seek a third term in 1990. Ultimately, Pete Wilson emerged as the Republican gubernatorial candidate, winning against Democrat Dianne Feinstein in November 1990.

## LEAVING THE PROBLEM TO PETE

Despite end-of-Cold-War concerns, the Department of Finance did not forecast an economic slowdown when the governor made his proposal for the 1989–1990 budget in January 1989. But the optimism was unwarranted. Deukmejian's 1989–1990 budget, signed a week after the July 1 deadline, ended in significant deficit despite substantial cuts by the governor using his veto power. As a result, the general fund reserve was partly depleted. The stage was set for worse results in 1990–1991, the last budget to be proposed and signed by Deukmejian. Just as Jerry Brown had left a major fiscal problem for George Deukmejian to inherit, so did Deukmejian leave a fiscal crisis for Pete Wilson.

Although the economic outlook was becoming cloudy in early 1989, the governor called a “transportation summit” in February and another in March. Traffic congestion is a major concern in California. Political forces around transportation infrastructure cut a deal with the educational establishment and put Prop 111 on the ballot in June 1990. If there was to be investment in transportation, a new revenue source would be needed, something Prop 111—termed by Willie Brown “an awesome legislative achievement”—promised to provide.<sup>41</sup> When put to the voters, Prop 111 passed with 52.4% of the vote.

Prop 111 added another formula to Prop 98 and set the share of any Gann surplus going to K-14 at 50%. It carved out exceptions to Gann for transportation and capital projects and raised the gas tax. In an exception to his usual negative stance on tax hikes, Deukmejian supported the gas tax increase (9 cents/gallon) or at least the idea of putting it on the ballot for voters to decide. Just as Prop 98 used concerns about education to begin the gutting of Gann, so concerns about traffic were used to complete the process under Prop 111. The modified Gann limit was a non-constraint for a decade thereafter. It was only at the next budget peak during the dot-com boom that the potential for a Gann constraint arose.

Official estimates now indicate the modified Gann limit was exceeded in 1999–2000, but the overage was not detected at the time and no rebates were provided. The subsequent dot-com bust and the resulting budget crisis of the early 2000s once again made the modified Gann limit a non-issue.

Deukmejian's January 1990 budget proposal for fiscal 1990–1991—the budget that would be inherited half way through by his successor—started with cautionary notes. Soon, the legislative analyst was pointing to a need for cutbacks to make the budget balance.<sup>42</sup> As disappointing revenue

<sup>40</sup> “Support Declines for Props. 95, 97, 98, 99,” *Sacramento Bee*, October 26, 1988.

<sup>41</sup> “Capitol Saved from Disgrace,” *Sacramento Bee*, July 2, 1989.

<sup>42</sup> “New State Budget Means Cuts in Services, Analyst Says,” *Sacramento Bee*, February 22, 1990.

reports arrived for the current fiscal year (1989–1990), it became apparent that the state was already in deficit. But in a gubernatorial election year—with the gas tax hike under Prop 111 already on the June ballot—there was no incentive for candidates to focus on fiscal difficulties.

However, the governor—who was not running for anything—threatened vetoes if fiscal “reforms” were not part of the budget package.<sup>43</sup> In May 1990, he ordered a freeze on certain categories of spending and personnel. His originally proposed 1990–1991 budget was not balanced and now seemed likely to more than deplete the general fund reserve.<sup>44</sup>

Deukmejian submitted a list of major cuts, including suspension of Prop 98 guarantees. Given the magnitude of the cuts required to deal with the revenue squeeze, however, the July 1 budget deadline came and went without an agreement. By the latter part of July, judges were ordering the state controller to pay various bills despite the lack of a budget. A new budget was finally signed at the end of July, followed by vetoes of over \$1 billion.

The governor had to give up on his Prop 98 suspension, which had stalled the budgetary negotiations.<sup>45</sup> His intent was to maintain a reserve. But final estimates put the reserve when the 1990–1991 ended at around -\$900 million. By September 1990, the California Field Poll found that seven out of 10 surveyed thought that Governor Deukmejian was leaving the state the same or worse than when he entered office in 1983.<sup>46</sup>

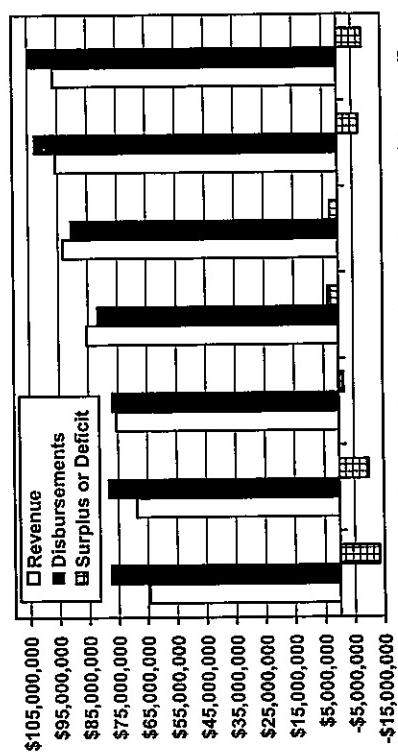
After the November 1990 election, the outgoing governor called the legislature back into session to deal with a further drop in projected revenues. He imposed more spending cuts and a hiring freeze. But the legislature effectively decided to await the new governor and took no action, a repeat of what occurred during Jerry Brown’s final days. Absent action in the lame duck legislative session, the problem was passed to Deukmejian’s successor. In an understatement, Pete Wilson—shortly before taking office—said, “It’s going to be tough. I’m going to present a budget . . . where I am compelled to spread some pain.”<sup>47</sup> Indeed, much of Wilson’s first term as governor revolved around budget pain.<sup>48</sup>

## DÉJÀ VU ALL OVER AGAIN

By his second term, Pete Wilson was able to resolve the fiscal problem, in part because the dot-com boom in northern California was beginning to overwhelm the depressed economy in the south where aerospace cutbacks were concentrated. But along the way, Wilson enacted a significant tax hike. Wilson’s successor—Gray Davis—had a rising economy and a large influx of revenue when he took office in January 1999.

It was left to Davis to repeat the drama of Jerry Brown (for whom Davis had been chief of staff), going from boom to bust. As Figure 2 illustrates, California’s fiscal situation had deteriorated into chronic deficits in the early 2000s. Davis was reelected against a weak opponent in 2002. But the budget crisis played a major role in Davis’ recall in 2003 and his replacement by Arnold Schwarzenegger. At the time, Davis had accumulated substantial short-term debt after repeated deficits had depleted the sizable reserve built up in the dot-com era. The immediate cash crunch was handled by voter-approved, large-scale, long-term borrowing for general operations during the first year of the Schwarzenegger administration. After that period, various positive developments aided the state’s fiscal outlook until the housing bubble, which had substantially enhanced state revenue, burst.

**Figure 2: Adjusted Cash Statement (\$ thousands)**



Source: California State Controller, June reports on General Fund Cash Receipts and Disbursements (<http://www.controller.ca.gov/ard/cash/index.shtml>).

<sup>43</sup> Ibid.  
<sup>44</sup> “Duke Freezes State Spending, Order Goes Into Effect Immediately to Reduce Flow of Red Ink,” *Sacramento Bee*, May 11, 1990.

<sup>45</sup> A.G. Block, “What Us Worry? Budget Deadlock Takes the State to the Brink,” *California Journal*, September 1, 1990.

<sup>46</sup> “Dimmer View of Deukmejian,” *Sacramento Bee*, September 3, 1990.

<sup>47</sup> “Budget Shortfall Soaring, Wilson Could Inherit Up to \$10 Billion Deficit,” *Sacramento Bee*, December 28, 1990.

<sup>48</sup> Daniel J.B. Mitchell, “Duke, Is There Perhaps Something You Forgot to Tell Me? Pete Wilson’s First-Term Struggle with the California Budget,” *Southern California Quarterly*, forthcoming 2009.

## HE SHOULD HAVE KNOWN IT COULD BE LIKE THIS

Like Deukmejian and Davis, Schwarzenegger was left to cope with a state budget that tends to be balanced only in good times. The problem for California is that the average condition of the economy is a mix of peaks, troughs, and periods in-between. Schwarzenegger made the problem of peak-only balance worse by cutting the “car tax” that had just been raised by Davis.<sup>49</sup> But he also inherited Prop 13’s de facto shift of responsibility for schools and other local services to the state. And he inherited Prop 98’s mandated education spending by formula, an indirect political legacy of Prop 4, which in turn was a political by product of Prop 13.

Finally, Schwarzenegger inherited another legacy of the Deukmejian era: term limits for legislators. In 1990, voters passed Prop 140, which imposed those limits. The powerful assembly speaker, Willie Brown, was made the target of the campaign for term limits. Because the limits were not retroactive, Pete Wilson could still cut deals with Willie Brown on the budget. But neither Davis nor Schwarzenegger had long-term experienced legislative leaders such as Willie Brown with whom to work on fiscal affairs.

Deukmejian had remained heavily focused on budget matters throughout his two terms. In contrast, Schwarzenegger tended to prefer big issues such as global warming, the “hydrogen highway,” infrastructure, and universal health care. He liked the idea of “reform” more than the specifics. Thus, once the immediate fiscal crisis of 2003 had been resolved in 2004 by long-term borrowing, the governor proposed a variety of reform initiatives in 2005—only one of which directly related to the budget. Schwarzenegger’s “year of reform” quickly evolved into an unsuccessful fight with state labor unions in which all his initiatives failed.<sup>50</sup>

In 2006—a gubernatorial election year—Schwarzenegger restored his popularity and won reelection by pushing about \$40 billion in infrastructure. But the infrastructure was to be financed by borrowing, a departure from a California tradition—particularly with regard to transportation—of pay-as-you-go finance.<sup>51</sup> The year 2007 target was to enact a state universal

health care system. But gubernatorial attention wandered until late in the calendar year, budget concerns reemerged, and the health plan failed.<sup>52</sup>

When the governor introduced his initial budget proposal for 2008–2009, the immediate fiscal crisis was apparent. However, the governor’s main proposal was to set up a large rainy day fund, about 12% of the general fund. But rainy day funds can be accrued only when the economic sun is shining, which it surely wasn’t by then. Moreover, history has some lessons. Gray Davis had accumulated a reserve in the general fund of about 12% at the peak of the dot-com boom, a de facto rainy day fund of the size Schwarzenegger proposed. But that reserve mainly delayed any adjustment for a year; the legislature instead burned through the cash available. In any event, after introducing the rainy day concept in January 2008, Schwarzenegger did not put it on the June or November ballots.

What he did put on the November 2008 ballot was Proposition 11, a redistricting reform that narrowly passed. In terms of the immediate budget crisis, however, redistricting could have no effect because it could not occur before the 2010 Census. Even as a long-term reform, redistricting is problematic from a budgetary perspective. It likely will produce a few more Republicans in the Democratic-dominated legislature, perhaps in 2012. Given the two-thirds vote requirement, that shift could arguably make it more difficult to enact budgets. Or it might make it easier—if more competitive legislative districts produce more moderate, compromising legislators. No one knows what the net result will be.

California’s constitution has long required the two-thirds vote of both legislative houses to pass a budget. Prop 13 of 1978 required a two-thirds vote to enact tax increases. Without legislative discipline, budget stalemates are inevitable in hard times because a unified minority can block compromises. Thus, California’s 2008–2009 budget was signed only in mid-September 2008, two and a half months late. And it immediately became apparent that the budget was not anywhere near balanced and that the state faced a fiscal emergency.

During the negotiations for the September budget, Governor Schwarzenegger reversed his prior anti-tax stance and (unsuccessfully) proposed a sales tax increase. He again called for a tax increase as part of an emergency budget session of the legislature after the November 2008 election. The governor’s rationale for this shift on taxes was that the budget crisis was a reflection of the wider recession and could not have been foreseen. But the prior year’s budget was already in deficit, the locals.

<sup>49</sup> The car tax is essentially a property tax on autos, collected by the state but passed to local governments. The legislature cut the tax during the late 1990s dot-com boom and reimbursed the locals for lost receipts. However, there was a trigger placed on the cut to reverse it if the state faced a budget crisis. Davis ruled that there was a crisis before the 2003 recall and raised the tax. Candidate Schwarzenegger said if elected, he would undo the increase and he did upon taking office, thus again obligating the state to reimburse the locals.

<sup>50</sup> Daniel J.B. Mitchell, “They Want to Destroy Me: How California’s Fiscal Crisis Became a War on Big Government Unions,” *Working USA*, 9 (March 2006), pp. 99–121.

<sup>51</sup> Governor Earl Warren began the California freeway system on a pay-as-you-go basis, raising the gas tax and putting the receipts into an earmarked trust fund for roads in 1947.

See Daniel J.B. Mitchell, “Earl Warren’s Fight for California’s Freeways, Setting a Path for the Nation,” *Southern California Quarterly*, 88 (Summer 2006), pp. 205–238.

<sup>52</sup> Daniel J.B. Mitchell, “Something Different in the Air? The Collapse of the Schwarzenegger Health Plan in California,” *Working USA*, 11 (June 2008), pp. 199–218.

as Figure 2 shows. The bursting of the real estate bubble, the rise in foreclosures, and the spreading financial consequences all pre-dated the signing and unraveling of the 2008–2009 budget.

Lessons from the past suggested that lame-duck emergency sessions of the legislature don't produce fiscal results. Governor Jerry Brown's session in late 1982 and Governor Deukmejian's emergency session in late 1990 did not produce solutions to deteriorating budgets. In keeping with these past precedents, Governor Schwarzenegger's emergency session in late 2008 also produced a stalemate and no action. In an unusual action, Schwarzenegger's budget director produced a preliminary budget proposal on New Year's Eve that involved mid-year cuts in the 2008–2009 budget, further cuts for 2009–2010, tax increases, and short-term borrowing. In the background were dire warnings that the state was running out of cash and might have to begin issuing registered warrants (IOUs) to providers of state services and other claimants on the treasury.

California's fiscal dilemma is magnified by the sheer size of the state and its two-thirds vote requirements for budgets and tax increases. The problem is compounded by voter initiatives that have inadvertent consequences and constrain the political leaders who are ultimately charged with state public policy. Nonetheless, the governor plays a key role—or should—in the budget process. The role requires a tight focus on priorities.

By calendar 2008, long-term reforms favored by the governor such as initiatives on redistricting and rainy day funds had become lower priorities than an immediate solution to the deteriorating budget. Such a solution might have involved a temporary increase in gubernatorial ability to cut spending and/or a temporary tax increase. But no effort was made by the governor to go to the voters with such interim solutions in 2008. Calendar 2009 began with the spectacle of Democrats proposing an artful, but possibly illegal, device to circumvent the two-thirds rules on taxes and the governor proposing a tax increase despite continuing Republican opposition. Meanwhile the legislative analyst was suggesting that the New Year's Eve budget's proposal for short-term borrowing might be illegal under the provisions of the voter-approved propositions the governor used to borrow his way out of the 2003–2004 budget crisis.

When the governor called the failed emergency budget session in fall 2008, he was effectively saying, "I never knew it could be like this." But as this article points out, it *had* been like this in 1982–1983, in 1990–1991, and in 2003–2004. Thus, as Deukmejian had in 1990, Governor Schwarzenegger found himself in 2008–2009 with the same budget crisis he had inherited from his predecessor. But unlike Deukmejian, he had no immediate successor to whom he could hand it. The next gubernatorial election is not until 2010.